



INTERNAL AUDIT SPECIAL ASSIGNMENT PAYROLL

March 4, 2002

Roanoke City Council Audit Committee
Roanoke, Virginia

We have audited Payroll in accordance with generally accepted government auditing standards.

BACKGROUND

On December 3, 2001, a concern was filed with the Municipal Auditing department alleging that certain compensatory time was inappropriately paid out as overtime to staff in the Payroll department. It was also alleged that an employee was allowed to contribute amounts to an ICMA account that exceeded the limits allowed by law. In response to these allegations, we initiated an audit in the payroll area.

Overtime and Compensatory Time:

The Fair Labor Standards Act (FLSA) defines the allowable hours for a normal work week and requires employers to pay employees overtime at 150% of their normal rate for hours worked in excess of allowed hours. Application of the Act was broadened to include local governments in 1985 and has provided the option for local governments to use compensatory time in lieu of overtime pay. Provisions in the FLSA allow employers to “exempt” employees from the provisions of the Act if their jobs meet certain criteria. Provisions requiring the City to pay overtime or award compensatory time do not apply to “exempt” employees. However, the City has gone beyond the requirements of FLSA in its Personnel Operating Procedures (POP), providing flexibility for management to award both overtime and compensatory time to exempt employees in special situations.

POP #18 regulates overtime compensation and allows overtime to be paid to exempt employees when specifically approved by the City Manager. This policy requires that all overtime be paid at a rate of 150% of the employee’s regular hourly rate. POP #25 regulates compensatory time and states that exempt employees in pay grades 15 and below may earn compensatory time when pre-approved by the director or division manager. The policy does not make any provision for paying out compensatory time earned as overtime pay. The policy limits the annual carry-over of compensatory time from one fiscal year to another to 80 hours. It also states that employees will not be paid for their accumulated compensatory time when they leave City employment.

Retirement:

City employees can participate in the City's ICMA 457 deferred compensation plan. The federal tax code establishes the maximum contribution allowed under the plan and in 2001 the limit was \$8,500 or 33 1/3% of includable income for the calendar year. The code allows employees within three years of retirement age to elect a catch-up provision and contribute up to \$15,000 in each of those three years if certain other criteria are met. Contributions matched by the City are included in the annual contribution limit. The City currently matches contributions up to \$25 per pay period for City employees.

PURPOSE

The purpose of our audit was to determine if certain overtime disbursements were made in accordance with the federal law and City policy, and to determine if contributions to certain employees' ICMA plans complied with applicable federal laws under code section 457.

SCOPE

We audited payroll procedures in place as of December 31, 2001. We evaluated transactions occurring between January 1, 2000 and December 31, 2001. We limited our testing to the areas of ICMA contributions, pay for accumulated compensatory time, and overtime pay to exempt employees.

METHODOLOGY

We obtained an understanding of relevant processes by reviewing City of Roanoke Personnel Operating Procedures and the ICMA Plan Document and Trust. We referred to FLSA guides issued by the US Department of Labor when evaluating compliance with overtime law. We used the US Master Tax Guide printed by KPMG to evaluate compliance with IRS tax code section 457, deferred compensation. We interviewed personnel from Finance, Retirement, and Human Resources to verify our understanding of the policies and processes.

RESULTS

Based on our review of overtime paid to exempt employees, we determined that there were no violations of the Fair Labor Standards Act. The following findings were discussed with management based on the results of the audit:

Finding 01: Conversion of Compensatory Time into Overtime

Employees in the Payroll department were paid for their compensatory time earned at their regular rate. Over calendar years 2000 and 2001, these employees converted approximately \$28,500 of compensatory time into overtime pay. Based on our review, we do not believe such a conversion of compensatory time into overtime pay is provided for under either POP #18 (overtime) or #25 (compensatory time). The Director of Finance requested the payments and the Director of Human Resources and the City Manager approved those requests. We believe the requests and approvals were made based on a general perception that this was allowed under City POP. This perception

was in part due to a precedent set in 1991 when the Finance Director at that time requested permission to pay retirement employees straight time for a specified period of time at his discretion due to the extra work required to implement a new retirement system. Also, POP #18 clearly allows exempt employees to receive overtime at 150% of their normal rate when approved by the City Manager. However, POP #18 does not include a provision for converting compensatory time into straight pay. The compensatory time policy (POP #25) does not provide for paying out compensatory time in any case. The policy specifies that employees will lose any compensatory time on the books in excess of 80 hours each July 1. The POP also expressly states that employees can only take compensatory time when approved by their supervisor and that employees will not be paid for compensatory hours when they leave City employment. We noted that 35 City employees lost a total of 1,770 hours of compensatory time when balances were rolled over last June 30, 2001.

Recommendation 01

We have worked with management from Human Resources and Finance to evaluate the utilization of compensatory time and overtime from the perspective of staffing and personnel management. Based on these discussions, those involved agreed that the personnel operating procedures involved (#18 and #25) should be revised as follows:

POP for compensatory time (#25) should clearly state that compensatory time cannot be converted to regular pay in any situation. It should be cross-referenced to those sections in POP #18 that cover options for paying exempt employees overtime.

POP for overtime (#18) should allow exempt employees to be paid at their regular rate of pay for overtime hours or at time and a half.

POP #18 should clearly state criterion that managers should consider when evaluating using overtime as a solution to a staffing problem.

POP #18 should require written justification that is presented to the City Manager for approval before overtime will be paid. These approvals should have a limited life to ensure staffing issues are reevaluated and consideration is given to adding staff.

Management's Response 01Finance:

We concur that the Personnel Operating Procedures as written did not specifically provide for the payments made for compensatory time. However, we also believe that the substance of the payments rendered to our employees was in keeping with the provisions of our policies. POP #18 permits payment of overtime to exempt employees at time and one half. Our payments were made retroactively at straight time for overtime worked in excess of allowable carry over amounts at the end of certain fiscal years. The intent of the payments was clearly stated in the requests for payment. Authorization for all payments was obtained from the Directors of Finance, Human Resources and City Manager. Our City Attorney's Office has advised that no state or federal laws were violated.

The recommendations outlined in the audit report will be implemented. Additionally, measures have been put in place to assure that all overtime and compensatory time are approved in advance of the employee working the additional hours. Lastly, the staffing level for the entire department will be evaluated and recommendations made to avoid employees having to work excessive hours of overtime and compensatory time.

Human Resources:

Written justification to pay overtime is already part of the process, however, more clarification may be needed as specified in the third bullet.

Finding 02: ICMA Employee Contributions in Excess of Limits

In 2001, a City employee exceeded the legal contribution limit as defined by code section 457 for deferred compensation by \$9. This employee was using the catch up provision that allows an employee to contribute up to \$15,000 each of his or her final three years of employment. The Retirement department manually calculates the expected final contribution for the year. In this case, an error was made when projecting the total annual contribution. Based on the results of the audit, the Retirement department requested and received a refund of \$9 of employee contributions from ICMA. Retirement has now written a program that reports any employee exceeding the allowable annual contribution. Retirement ran this report and identified three additional employees exceeding the legal contribution limit for the calendar year ended December 31, 2001. All three accounts were corrected prior to W-2s being printed and released. Retirement plans to run and review this report every two weeks when payroll is processed.

Recommendation 02

Retirement should continue to monitor contributions using the biweekly exception report described above.

Management's Response 02

It should be clearly stated that the excess contributions referenced in the report were employee funds, not City funds. Approximately 1,600 employees participate in the ICMA deferred compensation plan. Four employees exceeded the contribution limits by relatively small amounts, due primarily to the manual process involved in monitoring the contribution limits. Those excess contributions have since been returned from ICMA. An automated routine has been implemented to monitor contribution limits. These procedures are now being performed each pay-period as a review of Section 457 contributions. The procedures will notify us if limits are exceeded so that corrections can be made immediately.

Finding 03: Outdated Approvals for Overtime

Over a period of years, the Payroll department has compiled a listing of exempt City employees that are eligible to receive overtime pay. The listing was compiled using authorization for overtime forms that were approved by the Department of Human Resources and forwarded to the Payroll department. The Payroll Department has not evaluated the list to ensure that all of the positions on the list are still approved for overtime. Additionally, the Department of Human Resources has not reevaluated the positions approved for overtime to ensure that overtime is still appropriate for the positions.

Recommendation 03

The Payroll department should work with the Department of Human Resources to periodically update its listing of exempt employees approved for overtime.

Management's Response 03

A list of exempt employees authorized to receive overtime is kept in the Department of Finance. This list has been updated via verbal communication and individual letters of approval from the Department of Human Resources. We have requested that the Department of Human Resources furnish an updated listing of exempt position titles approved for overtime. This shall include the date through which overtime may be paid to such exempt positions. It is our understanding that we will receive an updated listing before another payroll is processed. This listing will be maintained on a current basis.

CONCLUSION

Based on the results stated above, we conclude that certain overtime payments were not in accordance with City policies. We also conclude that certain employee contributions to ICMA were in excess of the limits allowed by law.

We would like to thank the Department of Finance, the Department of Human Resources, and the City Manager's office for their cooperation and assistance during this audit.

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